In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 110

In the Matter of
THE ALLIED PRODUCTS COMPANY,
Bankrupt.

HAROLD H. BARNETT,
Successor Trustee in Bankruptcy of
The Allied Products Company,
Petitioner,

vs.

MARYLAND CASUALTY COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit, and
BRIEF IN SUPPORT OF PETITION.

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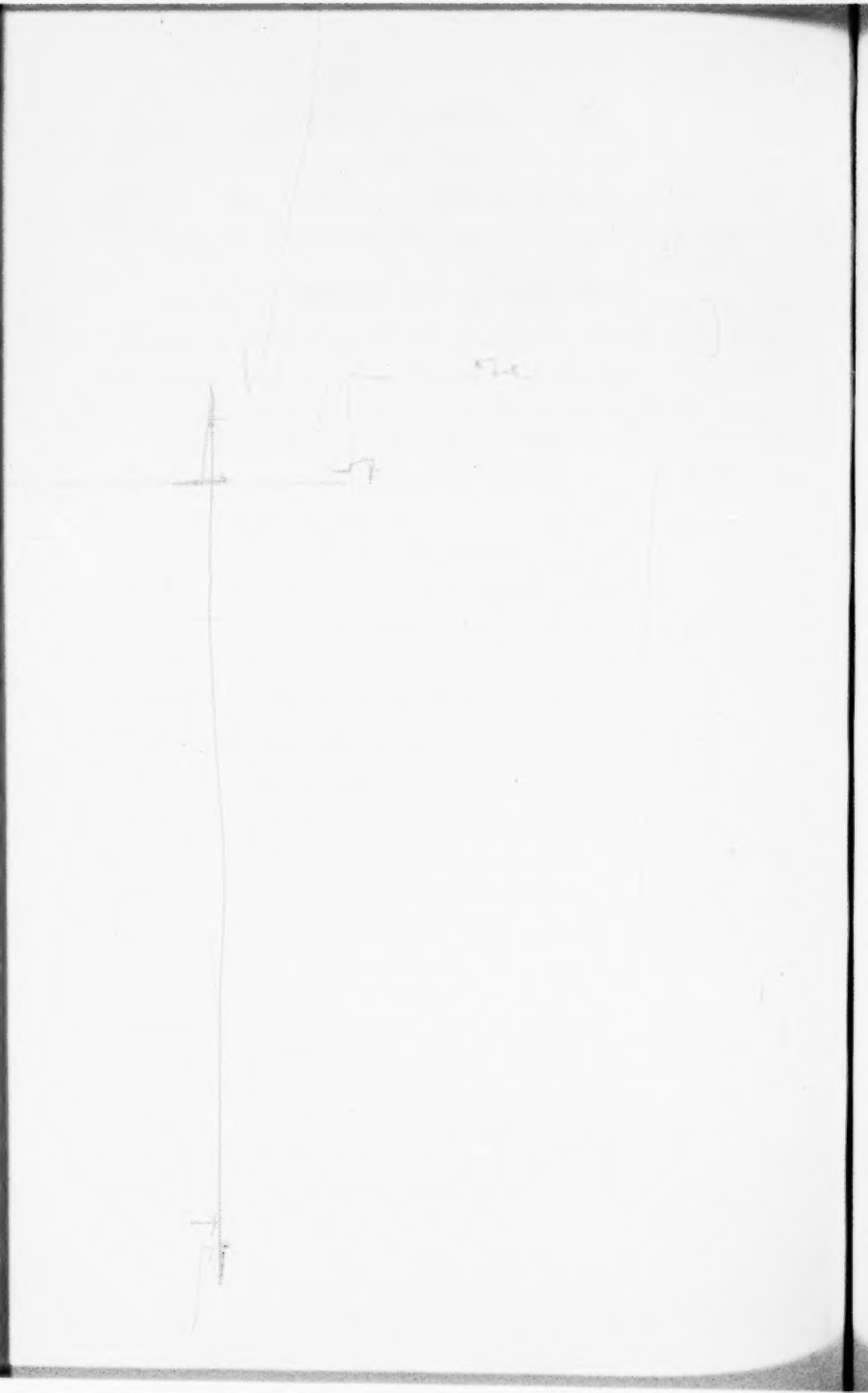

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Harold H. Barnett, Successor Trustee in Bankruptcy of The Allied Products Company, Bankrupt, respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF MATTERS INVOLVED.

1. LEGAL QUESTIONS PRESENTED.

This litigation presents an important phase of the question of the validity, as against the assignor's trustee in bankruptcy, of the assignment of certain accounts receiv-

able (moneys due and to become due to the assignor upon an existing contract), to secure both present and future obligations of the assignor to the assignee, where the assignee permits the assignor, until default, to collect and use the assigned funds for its own purposes without accountability to the assignee therefor.

The Bankrupt, a road paving contractor, executed two indemnity agreements to respondent Maryland Casualty Company (hereinafter called "Maryland"), surety upon its contract bonds, purporting to assign to Maryland all moneys due or to become due Bankrupt from Summit County, Ohio, upon two paving contracts, to indemnify Maryland against loss in connection with the immediate contracts and in addition against loss in connection with any future bonds which Maryland might thereafter execute for Bankrupt. Until Bankrupt should default Bankrupt had the right to collect and use (and did collect and use) all moneys becoming due upon the existing contracts without accountability to Maryland therefor.

The two Summit County contracts were completed and accepted without loss to Maryland. Summit County paid Bankrupt—as it had the right to do—the entire amount due except final balances, aggregating $4,188.34, which are the subject matter of this litigation.

Bankrupt entered into three subsequent paving contracts which were bonded by Maryland. Bankrupt defaulted in these three subsequent contracts prior to bankruptcy, and Maryland sustained losses thereon. Maryland contends that upon default in the subsequent contracts the assignments of the Summit County funds *ipso facto* became effective to hold the balance then due without further act of Bankrupt or of Maryland, and were valid as against the Trustee in Bankruptcy. The Trustee contends the assignments are void as to him in the capacity of a creditor

then holding a lien thereon by legal or equitable proceedings "as of the date of bankruptcy" (Bankruptcy Act, Section 70c, 11 U. S. C. A. 110c) since Maryland permitted Bankrupt to have unfettered dominion over the fund assigned.

The Referee held the assignments invalid against the Trustee because the Bankrupt was permitted to retain unfettered dominion over the funds assigned. The District Court reversed, holding that the assignments by their terms applied only to the balances remaining unpaid to Bankrupt at the time of default, and that the Bankrupt therefore had no dominion over the disputed funds. The Circuit Court of Appeals affirmed the District Court.

In so holding the Circuit Court of Appeals and the District Court

(a) failed to apply the rule announced by this Court in the case of *Benedict v. Ratner* (1925), 268 U. S. 353, 69 L. ed. 991, where this Court, construing the law of New York (which, as to transfers of tangible property as security, is substantially the same in this respect as the law of Ohio), held that the retention by the assignor of dominion over accounts receivable assigned as security, without accountability to the assignee therefor, was constructively fraudulent and void as against the assignor's trustee in bankruptcy; that such reservation of dominion prevented the effective creation of a lien; and that the results which flow from reserving dominion inconsistent with effective disposition of title were the same whatever the nature of the property transferred;

(b) decided an important question of the law of Ohio with respect to the basic requirements for a valid assignment, in conflict with applicable Ohio decisions. The Supreme Court of Ohio (like the Court of Appeals of New York) has repeatedly held that a chattel mortgage, even

though duly filed, is invalid if the mortgagor retains the right to dispose of the mortgaged chattels without accountability therefor.[1] The same rule applies whatever the nature of the property transferred, whether tangible or intangible. *Benedict v. Ratner, supra.*

2. STATEMENT OF FACTS.

Respondent Maryland Casualty Company became surety for Bankrupt on two performance bonds covering two road paving contracts between Bankrupt and the Commissioners of Summit County, Ohio, dated respectively, March 31, 1939 and May 25, 1939. Both contracts were completed by Bankrupt and accepted by the Commissioners on October 23, 1939, with all bills paid. The Commissioners made payments to Bankrupt as the work progressed, and only $1,136.20 due Bankrupt on the first contract, and $3,052.14 on the second contract remained unpaid at the date of bankruptcy. These sums are the subject matter of this litigation.

At the time Maryland executed Bankrupt's Summit County Bonds, Bankrupt signed "Applications for Contractor's Bond" giving pertinent data concerning the contracts, contract price, terms of payment, and the like, and containing "Indemnifying Agreement" on printed forms supplied by Maryland which contained a provision reading as follows (R. 9, 10):

> "In the event of claim or default under the bond(s) herein applied for, or in the event the undersigned [Bankrupt] shall fail to fulfill any of the obligations assumed under the said contract and bond(s), or *in the event of claim or default in connection with any*

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[1] *Collins v. Myers* (1847), 16 Ohio 547;
Freeman v. Rawson (1855), 5 O. S. 1;
Harmon v. Abbey (1857), 7 O. S. 218;
Enck v. Gerding (1902), 67 O. S. 245.

other former or subsequent bonds executed for us or at our instance and request **all payments due or to become due** *under the contract covered by the bond(s) herein applied for, shall be paid to the Company* [Maryland]—*and this covenant shall operate as an assignment thereof* and the residue, if any, after reimbursing the Company as aforesaid, shall be paid to the undersigned after all liability of the Company has ceased to exist under the said bond(s), and the Company shall at its option be subrogated to all rights, properties and interest of the undersigned in said contract, or contracts. * * *." (Emphasis supplied.)

Bankrupt subsequently, and while the Summit County contracts were being performed, entered into three additional contracts, one with the City of Cleveland, Ohio, and two with the United States Government, the performance of each of which was bonded by Maryland as surety. Bankrupt did not default in the Summit County contracts, but did default in these subsequent contracts before bankruptcy, but after the completion and acceptance of the Summit County contracts and after the Summit County funds became due and payable to Bankrupt,[2] and Maryland, after bankruptcy, sustained and paid losses upon the three subsequent contracts totalling $11,761.91 (R. 27).

Maryland claims that by virtue of the foregoing provisions of the two Indemnity Agreements it has valid as-

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[2] The Summit County contracts were completed and accepted by the Commissioners of Summit County on October 23, 1939 without default and with all bills paid (R. 17). The Summit County balances became due and payable to Bankrupt on that date, but were not paid. The first default occurred on December 16, 1939 (R. 18, Par. 18) when Bankrupt failed to pay a $2,119.00 bill to a materialman, due on that date, which bill was incurred in connection with one of the three subsequent contracts, and which bill was paid by Maryland on October 28, 1940. Bankruptcy occurred February 14, 1940. Similar defaults occurred in the other two subsequent contracts on December 20, 1939 and January 12, 1940, which losses were paid by Maryland after bankruptcy in October of 1940 (R. 18, 19, 25).

signments of the Summit County balances to apply against losses which it sustained on the three subsequent bonds signed by it. The Trustee claims that the assignments are constructively fraudulent and void as to him in the position of a levying creditor under the provisions of Section 70c of the Bankruptcy Act, (a) because Maryland permitted the Bankrupt to retain unfettered dominion over the moneys due upon the Summit County contracts until the date of bankruptcy, and (b) because the arrangement was such as to preclude the effective creation of a lien.

3. PROCEEDINGS BELOW.

On February 14, 1940 Bankrupt filed in the District Court a petition for reorganization under Chapter X of the Bankruptcy Act, and the matter was referred generally to a Special Master (R. 23). Maryland filed in the reorganization proceeding an amended application for an order directing the Commissioners of Summit County to pay to Maryland the moneys in dispute (R. 2). Reorganization having failed, the Company was adjudicated a bankrupt on December 27, 1940 and by order of the District Court Maryland's application was continued in the bankruptcy proceeding (R. 23). The Company as a debtor in possession in the reorganization proceeding, and after adjudication the Trustee, contested Maryland's application.

The matter was submitted to the Referee upon an Agreed Statement of Facts (R. 16). The Referee held the assignment of the funds in dispute invalid as against the Trustee in the position of a levying creditor upon two grounds pertinent here: (a) The assignment was void under the rule of *Benedict v. Ratner*, 268 U. S. 353, because Maryland permitted the Bankrupt to *exercise dominion over the fund* until the date of bankruptcy, and (b) the assignment was void under the applicable Ohio decisions

because of the dominion over the fund exercised by Bankrupt.[3]

The District Court reversed on the ground that as a matter of law the assignment applied only to the sums due and unpaid at the time of default or that might thereafter become due; that Bankrupt had no dominion over that part of the contract price remaining unpaid after default, and on that ground distinguished the *Ratner* case and the Ohio cases cited by the Trustee.[4]

The Circuit Court of Appeals affirmed the District Court upon the same grounds.[5]

B.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The discretionary power of this Court is invoked for the following reasons:

1. The decision of the Circuit Court of Appeals is in direct conflict with the decision of this Court in the case of *Benedict v. Ratner* (1925) 268 U. S. 353, which holds such an assignment conclusively fraudulent and void as against the Trustee in Bankruptcy of the assignor.

2. The decision of the Circuit Court of Appeals is in direct conflict with the long-established rule of the Ohio Supreme Court, applied in the case of mortgages of chattels, that the transfer of property for security where the

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[3] See Certificate of Referee upon Petition for Review (R. 34-62). The Referee further held that Maryland (the assignee), like a chattel mortgagee in Ohio, *could* validate the assignment as to future payments due from the obligor *if* it (the assignee) asserted possession over the fund in some way (by the appointment of a receiver, notice to the obligor, etc.), but that Maryland did not assert such possession prior to bankruptcy.

[4] Memorandum Opinion of District Judge (R. 62).

[5] Opinion of Circuit Judge Martin (R. 76).

transferor reserves the right to sell and use the proceeds without accountability, is void as against creditors:

Collins v. Myers (1847), 16 Ohio 547;
Freeman v. Rawson (1855), 5 O. S. 1;
Harmon v. Abbey (1857), 7 O. S. 218;
Enck v. Gerding (1902), 67 O. S. 245.

As this Court decided in the *Ratner* case, the reservation of dominion renders the transaction void whether the property transferred consists of chattels or of accounts receivable.

3. The decision of the Circuit Court of Appeals is in conflict with the rule as applied by the Courts of Appeals of Ohio. The Courts of Appeals of Ohio hold that a mortgage of rents in connection with a mortgage of real estate, even though duly recorded, is not effective against creditors of the mortgagor until the mortgagee reduces the rents to possession in some manner:

Norwood Bank v. Romer (1932), 43 O. App. 224, 183 N. E. 45;
Connecticut Life Insurance Co. v. Shelly Seed Corporation (1933), 46 O. App. 548, 189 N. E. 654;
Metropolitan Life Insurance Co. v. Begin (1938), 59 O. App. 5, 16 N. E. (2d) 1015.

4. An important question in the administration of the Bankruptcy Act is presented:

(a) It is common practice among surety companies signing contractors' bonds to require the contractor to assign to the surety all moneys due or to become due upon each contract bonded, as security against loss not only in connection with the particular contract bonded, but also in connection with any other contract theretofore or thereafter bonded by the surety for the same contractor. The assignment is made with the understanding that until a default shall occur in the performance of any such past, present or future contract, the contractor, notwithstanding

the assignment, may collect and use without accountability all payments made from time to time, even to the complete exhaustion of the fund assigned. Will such assignments be given effect in bankruptcy proceedings against the Trustee in Bankruptcy?[6]

(b) There are many states which follow the New York rule concerning the effect of retention of the power of sale with respect to mortgaged chattels, and hold such chattel mortgages void. Ohio is one of these states. This Court in the *Ratner* case held that the New York rule applied both with respect to accounts receivable, and to chattels. The same rule with respect to accounts receivable should be applied in the administration of the Bankruptcy Act in all states following the New York rule.[7]

WHEREFORE, Your petitioner respectfully prays that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Sixth Circuit commanding that Court to certify to this Court for review and determination the full and complete transcript of the record and all proceedings in the case entitled, "In the Matter of The Allied Products Company, Bankrupt, Harold H. Barnett, Successor Trustee, etc., Appellant vs. Maryland Casualty Company, Appellee," being cause No. 9286 upon the docket of said Circuit Court of Appeals, and that the

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[6] While the extent of this practice of surety companies is not susceptible of statistical proof, it is undoubtedly widespread—three separate surety companies have asserted similar assignments in the present bankruptcy proceeding alone. (See opinion of District Judge, R. 62.) The question presented is similar to that recently considered by this Court in *Corn Exchange Bank v. Clauder, Trustee* (March 8, 1943), 87 L. ed. Ad. Sheets 632, 63 S. C. R. 679, which involved the question of the validity of the so-called "no-notice" assignments of accounts receivable.

[7] See 2 *Glenn Fraudulent Conveyances* 1009, citing numerous cases. The "vast majority" of states which have considered the question hold that a chattel mortgage where the mortgagor retains possession with power to sell and without accountability is invalid as against creditors of the mortgagor. 39 *Columbia Law Review* 1328, citing cases and authorities from twenty-four states.

decree of said United States Circuit Court of Appeals for the Sixth Circuit in said cause may be reversed by this Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

HAROLD H. BARNETT, *Successor Trustee in Bankruptcy of the Allied Products Company,*

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